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SEC Ignoring Defense Contractors

The scandal of defense contractors seems to grow by the hour. Nine of the top 10 contractors are under investigation by the Defense Department's inspector general for misconduct. At least 36 of the 100 largest contractors are under criminal investigation by other agencies.

But the arms makers have a powerful friend among the watchdog agencies: the Securities and Exchange Commission, which has given defense contractors a free ride on the gravy train. It has declined to force these companies to make full disclosure of important financial troubles, as they are required to by law and SEC regulations.

The stock-buying public is entitled to know about problems that might affect a company's financial health and thus the price of its stock, especially cost overruns that eat into profits.

But the SEC has accorded tender treatment to defense contractors who fail to divulge important information. In the last 10 years, the SEC has formally investigated only two defense contractors, General Dynamics Corp. and Litton Industries.

Why? We found the answer in an internal memo dated April 14, 1980, written by then-SEC Chairman Harold Williams to his enforcement chief, Stanley Sporkin.

"I have long felt that, during the 1960s and 1970s, the practice of defense contractors of underbidding a fixed-price contract, incurring extensive overruns, and then seeking to recover the overruns through negotiations with the government, was both widespread and notorious," Williams wrote.

In discussing the case of Litton Industries, Williams noted that an article quoted Litton executives as justifying their failure to reveal cost overruns on grounds that "it would make our negotiations with the Navy more difficult."

Williams then said, referring to the magazine article: "Was not that disclosure sufficient to alert the market that significant claims of uncertain value had been filed by Litton in an effort to recover its costs? Do the securities laws require more detailed disclosures . . . [when] such disclosure might prejudice then ongoing negotiations?"

Williams seems to have been making a spirited defense of corporate secrecy. He apparently bought Litton's line that disclosure of accurate information on its overruns might hurt its bargaining position.

Sporkin (now the CIA's general counsel) stated without equivocation that "companies have an obligation to make disclosure of all material facts concerning long-term contracts even if unfavorable to the company, and . . . such disclosure should be made specifically in the company's financial statements."

One former SEC official told our associate Donald Goldberg that Williams fought the Litton investigation, and let it be known that he would resist other such cases.

This attitude, according to Sen. William Proxmire (D-Wis.), who is investigating the SEC's kid-glove treatment of scandal-ridden General Dynamics, has been adopted by Williams' successor, John Shad. The record shows that the SEC continues to go easy on defense contractors.